

POLICY *focus*

RECIPES FOR RATIONAL GOVERNMENT

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The Threat to Independent Contracting: AB5

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What You Should Know

Today's workplace is vastly different from a generation ago. Workers now have an array of arrangements that allow them to maximize flexibility. This is a priority for many individuals who want to balance employment with other personal and professional priorities. For example, working parents, in general, **prefer** flexible working conditions to a higher salary. In **surveys**, Millennial workers also say they are willing to or have left a job that does not offer flexibility.

Unlike traditional employees, independent contractors (including freelancers, gig workers, and consultants) control when, where, and how they work. This flexibility is one reason that contracting jobs are increasing in popularity. Technology has expanded independent contracting opportunities as digital platforms match workers to businesses looking to hire them for tasks and projects such as ridesharing, secretarial work, or delivery services, in what is known as the gig economy. In 2019, an estimated **57 million** Americans freelanced and over half of them say no amount of money would persuade them to take a traditional job.

So why, then, are policymakers seeking to limit opportunities for independent contracting? They claim that, by implementing policies that make it more difficult to be classified as independent contractors, they are protecting workers from exploitation and ensuring that public coffers are not deprived of tax revenue. California's Assembly Bill 5 is the latest law to inflict wide-ranging harm on freelance workers across the state. If other states or Congress adopts AB5's standards, this will destroy desired flexible working opportunities for millions of workers nationwide.

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Why It Matters

American workers, particularly women and younger workers, are increasingly seeking out flexible work arrangements that can accommodate their time constraints or maximize work-life balance. Laws such as California's AB5, which adopt stricter standards for classifying workers as independent contractors, come with serious consequences. AB5 will:

- **Raise costs for businesses.** Businesses that are forced to reclassify their independent contractors as employees must now comply with California's wage and hour laws, unemployment insurance, and other labor laws that increase labor costs by an estimated 20-30 percent. This leaves fewer resources for job creation and wage growth.
- **Threaten economic security of workers.** Some businesses are opting to lay off their freelance workforce rather than convert them to employees. Independent contractors report losing contracts, being laid off from projects and unable to find freelance work.
- **Kill flexible work arrangements.** Millions of Americans prefer to be their own bosses instead of working as employees.

Creating exemptions for specific occupations is the wrong solution. It perpetuates a pay-for-play system that is undemocratic and unfair to those who cannot afford to buy protections. Lawmakers should instead allow workers in all industries the freedom to customize their careers.

More Information

A Nation of Independent Contractors

Independent contractors have long been a part of our workforce. Handymen, journalists, and HR professionals are examples of freelance workers who are paid for completing a specific task or project instead of a salary. Today, **1 in 5** jobs in America is held by an independent contractor, and that proportion is expected to grow to half within a decade.

Technology is a big driver of freelance work today. On-demand tech platforms connect workers willing to perform a task, such as driving for Uber and Lyft, performing handyman work through TaskRabbit, or delivering meals through DoorDash, with those seeking to hire them in what we call the gig economy.

Independent contractors are different from employees of companies. These are two distinct employment classifications based on specific factors, and this classification determines the tax and legal obligations for businesses. For example, businesses must withhold taxes and comply with federal and state wage and labor laws for employees, but not for independent contractors.

Independent contractors understand that there is a tradeoff with this arrangement. In exchange for a guaranteed salary and benefits, they receive the flexibility to determine their

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schedule and the autonomy to decide whom to work for, what work they do (or don't do), and how they get it done (i.e. being their own boss).

Nearly **75 percent** of freelancers are working independently by choice. Nearly half of freelancers (42 percent) depend on contract work because personal circumstances such as health issues or childcare needs prohibit them from working as an employee for a traditional employer.

The *Dynamex* Decision

In California, an important legal standard defining independent contractors was established by the state Supreme Court in the 1989 case *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*. The Court held that multiple factors can be considered in determining whether a worker is an independent contractor, but not all of those conditions had to be met. This was a flexible standard that allowed many workers to be considered independent contractors.

However, in a landmark 2018 decision (*Dynamex Operations West, Inc. v. Superior Court of Los Angeles, Cal.*), the California Supreme Court replaced the *Borello* standard with a new rigid, three-pronged "ABC" test in which all three conditions had to be satisfied for a worker to be an independent contractor.

In this case, the California Supreme Court placed the burden on businesses to prove that workers are not employees. They must prove all three of the following:

- (A) The worker is free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- (B) The worker performs work that is outside the usual course of the hiring entity's business.
- (C) The worker is customarily engaged in an independently established trade, occupation or business of the same nature as that involved in the work performed.

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AB5

In 2019, the California legislature codified the *Dynamex* decision by passing Assembly Bill 5, a law that drastically changed the employment arrangements for at least one million independent contractors across the state. The law, which took effect January 1, 2020, requires that employers prove they meet the ABC test for their workers to be lawfully classified as independent contractors.

Proponents naively assume that businesses will simply hire their contracted workforce as employees and offer them all the benefits of salaried workers. This ignores the substantial

costs to businesses, as well as the preferences of workers. For new employees, businesses must now comply with California's wage and hour laws, including minimum wage, overtime, meal periods and rest breaks as well as unemployment insurance, workplace safety laws, and other labor laws. It has forced them to decide whether to accept a drastic increase in labor costs—estimated at **20-30 percent**—or eliminate their independent contractor workforce.

AB5 is known as the gig economy bill because it has massive implications for gig economy companies such as Uber, Lyft, and DoorDash. Uber and Lyft report employing a combined half a million drivers in California as independent contractors. Proponents argue that gig economy companies exploit workers by classifying them as independent contractors to avoid paying minimum wages, providing leave and other benefits. They wrongfully ignore that these workers are not looking for traditional workplace benefits but the flexibility to work on their own schedules and terms. Nearly **two out of three** women working in the gig economy (61 percent) would prefer to be independent while only 12 percent said they would want to be an employee of the company for which they gig.

AB5's harmful impact has hit many occupations outside of the gig economy: Architectural designers, brand and advertising professionals, chiropractors, dental billers, event planners, child caregivers, funeral assistants, optometrists, paralegals, artists, producers, engineers, musicians, dancers and more. In addition, AB5 specifically limits publications from accepting more than 35 pieces a year from freelance writers, photographers, and newspaper cartoonists. This significantly limits the income of professionals in these careers.

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Not all independent contractors in the state are affected by AB5. After successful lobbying, lawmakers exempted many occupations including licensed insurance agents, real estate licensees, licensed barbers and cosmetologists, and some construction industry workers. When a law has so many exemptions, we should question whether it's a good law for anyone at all.

AB5's Impact

AB5 threatens the economic and work security that independent contract work provides. The law's proponents claim that it replaces pay uncertainty inherent in gig work with work stability. However, when businesses eliminate their freelance workforce, independent contractors end up unemployed and with no work prospects. Vox Media, for example, laid off 200 freelance writers at the beginning of 2020 in response to AB5. Artists, writers, and other contractors also report losing their contracts and jobs and immediately, losing critical income. In a recent [survey](#), more than half of full-time independent workers say they feel more financially secure as independents than in traditional jobs.

Rideshare companies have said they may have to institute shifts, schedule drivers in advance, and reduce the number of drivers during slow hours or in less busy markets. These changes would reduce drivers' ability to drive when and where they desire. It may also lead to longer wait times, fewer available rides, and higher prices for consumers.

Beyond the immediate impacts of AB5, this law poses a threat to the long-term future of journalism. Independent journalists are a critical element of today's news landscape. They cover topics that in-house journalists lack the time, bandwidth, interest, or autonomy to pursue. Freelance journalists hold lawmakers accountable for their policies especially at the state and local levels, expose scandals and wrongdoing by lawmakers and businesses, and inform the public about issues that would otherwise go unreported.

Most worrisome about AB5 is that it has inspired other states and the federal government to introduce or consider adopting the tightened requirements for independent contractors. New Jersey introduced similar legislation in 2020. New York, Illinois, and Wisconsin have indicated they will consider an ABC test. Similar measures introduced in Wisconsin and Oregon failed to pass in 2019, but may be reintroduced in 2020. In addition, the U.S. House of Representatives passed the PRO Act (H.R. 2474) in February 2020, which, if it were to become law, would adopt AB5's harmful standard for classifying independent contractors nationwide.

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The Way Forward

AB5 has spawned a state-wide outcry. Workers across industries are rallying and speaking out about how this bill robs them of income and is killing their employment opportunities. Other industry groups are lobbying to gain exemptions for their members, but that is the wrong approach.

AB5 is fundamentally bad policy that should be reversed and abandoned. Rather than restrict opportunities, lawmakers should look to *expand* worker freedom and give all Americans the chance to design the life they desire.

Myth: Independent contractors do not pay taxes.

Businesses do not withhold federal and state income and payroll taxes from payments to contractors. However, freelancers and gig workers are still required to pay taxes on their own: federal income taxes (if their net earnings are \$400 or more); self-employment tax which covers Social Security and Medicare taxes; estimated quarterly tax payments (if they expect to owe \$1,000 or more in taxes); and income taxes and estimated quarterly taxes at the state level. At the start of tax season, businesses are required to provide their contractors a Form 1099-MISC reporting all of the income they paid in the previous calendar year (unless a contractor earned less than \$600, but she is still required to report that income). Failing to pay or underpaying taxes is unacceptable and can result in tax penalties, which should be enforced. Policymakers should focus on enforcement of existing tax law to prevent tax evasion rather than restricting the ways workers can structure their work.

What You Can Do

Get Informed

For more information about this issue visit:

- [Society for Human Resources Management \(SHRM\)](#)
- [Freelancers Against AB5](#)
- [California Labor & Workforce Development Agency](#)

Talk to Your Friends

Help your friends and family understand these important issues. Tell them about what's going on and encourage them to join you in getting involved.

Become a Leader in the Community

Get a group together each month to talk about a political/policy issue (it will be fun!). Write a letter to the editor. Show up at local government meetings and make your opinions known. Go to rallies. Better yet, organize rallies! A few motivated people can change the world.

Remain Engaged Politically

Too many good citizens see election time as the only time they need to pay attention to politics. We need everyone to pay attention and hold elected officials accountable. Let your Representatives know your opinions. After all, they are supposed to work for you!

CONNECT WITH IWF! FOLLOW US ON:

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Independent Women's Forum (IWF) is dedicated to building support for free markets, limited government, and individual responsibility.

IWF, a non-partisan, 501(c)(3) research and educational institution, seeks to combat the too-common presumption that women want and benefit from big government, and build awareness of the ways that women are better served by greater economic freedom. By aggressively seeking earned media, providing easy-to-read, timely publications and commentary, and reaching out to the public, we seek to cultivate support for these important principles and encourage women to join us in working to return the country to limited, Constitutional government.

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